**Treasury Management Strategy Report 2020/21**


**Summary**
**Report to Executive to consider and recommend to Council the Treasury Strategy for 2020/21**


**Portfolio** Finance
**Date Portfolio Holder signed off report:**

**Wards Affected** All

**Recommendation**

**The Executive is advised to RECOMMEND to Council that**

**(i) the Treasury Management Strategy for 2020/21 to this report;**

**(ii) the Treasury Management Indicators for 2020/21 at Annex C to this report;**

**(iii) the Minimum Revenue Provision policy statement and estimated minimum revenue provision payment table at Annex F to this report; and**

**(iv) the Treasury Management Policy Statement at Annex G to this report;**

**be adopted.**

## Resource Implications

1. The budget for investment income in 2020/21 is £140,000, based on an average investment portfolio of £13 million at an interest rate of 1.08%. The budget for debt interest paid in 2020/21 is £3.8million, based on an average debt portfolio of £164million at an average interest rate of 2%. If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different.

2. Funding for the proposed corporate capital programme for 2020/21 – 2022/23 will be funded by capital receipts.

3. Any changes required to the approved treasury management indicators and strategy, say due to changes in economic conditions, will be reflected in future reports for Executive and Full Council to consider.

## Key Issues

4. Treasury management is the management of the Council's cash flows, borrowing and investments, and the associated risks. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk is therefore central to the Council's prudent financial management.

5. The Council's portfolio of investments comprise funds available for longer term investment and short term investments sufficient to meet cash flow requirements.

6. Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

7. Investments held for service purposes or for commercial profit are considered in the Investment Strategy which is on this agenda.

8. In accordance with the MHCLG Guidance, the Council will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, or in the Council's capital programme or in the level of its investment balance.

**Options**

9. The Executive can receive or amend the report, or ask for further information.

10. The Executive can approve or amend the proposed recommendations to Council.

**Proposals**

11. The Executive is asked the approve and recommend the Council the adoption of:
    a) The Treasury Management Strategy for 2020/21
    b) The Treasury Management Indicators for 2020/21 at Annex C
    c) The Minimum Revenue Provision (MRP) Policy Statement at Annex F
    d) The Treasury Management Policy Statement at Annex G

**Supporting Information**

**<u>National and International Factors which influence the Council's Treasury Strategy</u>**

12. The Council's treasury management advisors, Arlingclose Limited have provided us their assessment of the wider external factors that the Council's investment

strategy needs to take in to account in terms of the economy, interest rates and credit outlook. This is set out below:

Economic background:

13. The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Council's treasury management strategy for 2020/21.

14. UK Consumer Price Inflation (CPI) for September registered 1.7% year on year, unchanged from the previous month. Core inflation, which excludes the more volatile components, rose to 1.7% from 1.5% in August. The most recent labour market data for the three months to August 2019 showed the unemployment rate ticked back up to 3.9% while the employment rate was 75.9%, just below recent record-breaking highs. The headline 3-month average annual growth rate for pay was 3.8% in August as wages continue to rise steadily. In real terms, after adjusting for inflation, pay growth increased 1.9%.

15. GDP growth rose by 0.3% in the third quarter of 2019 from -0.2% in the previous three months with the annual rate falling further below its trend rate to 1.0% from 1.2%. Services and construction added positively to growth, by 0.6% and 0.4% respectively, while production was flat and agriculture recorded a fall of 0.2%. Looking ahead, the Bank of England's Monetary Policy Report (formerly the Quarterly Inflation Report) forecasts economic growth to pick up during 2020 as Brexit-related uncertainties dissipate and provide a boost to business investment helping GDP reach 1.6% in Q4 2020, 1.8% in Q4 2021 and 2.1% in Q4 2022.

16. The Bank of England maintained Bank Rate to 0.75% in November 2019 following a 7-2 vote by the Monetary Policy Committee. Despite keeping rates on hold, MPC members did confirm that if Brexit uncertainty drags on or global growth fails to recover, they are prepared to cut interest rates as required. Moreover, the downward revisions to some of the growth projections in the Monetary Policy Report suggest the Committee may now be less convinced of the need to increase rates even if there is a Brexit deal.

17. Growth in Europe remains soft, driven by a weakening German economy which saw GDP fall -0.1% in Q2 and is expected to slip into a technical recession in Q3. Euro zone inflation was 0.8% year on year in September, well below the European Central Bank's target of 'below, but close to 2%' and leading to the central bank holding its main interest rate at 0% while cutting the deposit facility rate to -0.5%. In addition to maintaining interest rates at ultra-low levels, the ECB announced it would recommence its quantitative easing programme from November.

18. In the US, the Federal Reserve began easing monetary policy again in 2019 as a pre-emptive strike against slowing global and US economic growth on the back on of the ongoing trade war with China. At its last meeting the Fed cut rates to the range of 1.50-1.75% and financial markets expect further loosening of monetary policy in 2020. US GDP growth slowed to 1.9% annualised in Q3 from 2.0% in Q2.

Credit Outlook:

19. Credit conditions for larger UK banks have remained relatively benign over the past year. The UK's departure from the European Union was delayed three times in 2019 and while there remains some concern over a global economic slowdown, this has yet to manifest in any credit issues for banks. Meanwhile, the post financial crisis banking reform is now largely complete, with the new ring-fenced banks embedded in the market.

20. Challenger banks hit the news headlines in 2019 with Metro Bank and TSB Bank both suffering adverse publicity and falling customer numbers.

21. Looking forward, the potential for a "no-deal" Brexit and/or a global recession remain the major risks facing banks and building societies in 2020/21 and a cautious approach to bank deposits remains advisable.

Interest rate forecast:

22. The Council's treasury management adviser Arlingclose is forecasting that Bank Rate will remain at 0.75% until the end of 2022. The risks to this forecast are deemed to be significantly weighted to the downside, particularly given the upcoming general election, the need for greater clarity on Brexit and the continuing global economic slowdown. The Bank of England, having previously indicated interest rates may need to rise if a Brexit agreement was reached, stated in its November Monetary Policy Report and its Bank Rate decision (7-2 vote to hold rates) that the MPC now believe this is less likely even in the event of a deal.

23. Gilt yields have risen but remain at low levels and only some very modest upward movement from current levels are expected based on Arlingclose's interest rate projections. The central case is for 10-year and 20-year gilt yields to rise to around 1.00% and 1.40% respectively over the time horizon, with broadly balanced risks to both the upside and downside. However, short-term volatility arising from both economic and political events over the period is a near certainty.

24. For the purpose of setting the budget, it has been assumed that no new treasury management investments will be made and that existing loans will be financed at an average rate of 2%.

**Local Context**

25. On 30th November 2019, the Council held £164 million of borrowing and £13 million of treasury investments.

26. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), which usable reserves and working capital are the underlying resources available for investment. The Council's current strategy

is to maintain borrowing below their underlying levels, sometimes known as internal borrowing subject to holding a minimum of £5 million.

## Borrowing Strategy

27. The Council currently holds £164 million of loans, an increase of £25 million on the previous year, which it is using to fund its property acquisitions. The Council may borrow in advance to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £190 million, however the Council will incur a cost of carry until the funds are utilised.

28. A review of the Council's leases under IFRS16 which will come into effect on 1st April 2020 was undertaken. The Council has decided not to increase the Authorised Limit for Borrowing as the impact of IFRS16 was deemed to be insignificant.

Objectives:

29. The Council's main objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

Strategy:

30. Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to continue to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

31. The majority of the Council's borrowing is short term in order to take advantage of the low rates, however it has fixed some of its borrowing for the longer term to give certainty of cost in the future and reduce risk.

32. The Council has previously raised the majority of its long term borrowing from the PWLB but the government increased PWLB rates by 1% in October 2019 making it now a more expensive option. The Council may look to borrow loans from other sources, in order to lower interest costs and reduce over resilience on one source of funding in line with the CIPFA Code.

33. In order to manage risk on its short term borrowings, the Council has arranged fixed rate forward starting loans for £50m. These will replace the short term borrowing of the same amount and are due to start in 2021 and 2022. This has enabled certainty of cost to be achieved in the future whilst taking advantage of low interest rates in the short term.

Sources of borrowing:

34. The approved sources of borrowing are:
- Public Works Loan Board (PWLB) and any successor body
- Any institution approved for investments (see below)
- Any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds (excepts Surrey County Council Pension Fund)
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local Council bond issues
- Local Enterprise Partnerships
- Any other UK public sector body

In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:
- Leasing
- Hire Purchase
- Private Finance Initiative
- Sale and Leaseback

Municipal Bonds Agency:

35. UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance that the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will require the approval of Full Council and therefore a separate report would be required.

Short term and Variable Rate loans:

36. These loans leave the Council exposed to the risk of short term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below. Financial derivatives may be used to manage this interest rate risk (see section below)

Debt Rescheduling:

37. The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

Annual Minimum Revenue Provision (MRP) Statement:

38. When a Council borrows, it is required to indicate how it intends to fulfil its duty to make prudent provision for the repayment of the capital borrowed from revenue.

This provision is called the Minimum Revenue Provision or MRP. Best practice guidance recommends that Authorities prepare a statement of policy on making MRP in respect of the forthcoming financial year. The Council's MRP statement will be recommended to Council by the Executive on 18th February 2020 as part of the Capital budget for 2020/21.

39. The recommended policy is attached in Annex F and the forecast MRP is £m is shown in the table below:

| | 2018/19 actual | 2019/20 forecast | 2020/21 budget | 2021/22 budget | 2022/23 budget |
|---|---|---|---|---|---|
| **MRP Payment** | 1.400 | 2.159 | 2.213 | 2.274 | 2.320 |

Investment Strategy

40. The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's investment balance was £13 million. This is expected to remain at £13 million in 2020/21.

Objectives:

41. The CIPFA Code requires the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest return of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitable low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

Negative Interest Rates:

42. If the UK enters into a recession in 2020/21, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested. However any loss in income will be outweighed by savings on borrowing costs.

Strategy:

43. Given the increasing risk and very low returns from short-term unsecured bank investments, the Council aims to remain diversified into higher yielding asset classes during 2020/21 particularly for investments held for the longer term. The majority of the Council's surplus cash is currently invested in money market

funds, on the advice of our advisors Arlingclose. No changes are proposed to the 2020/21 investment strategy from that adopted in 2019/20.

Business Models:

44. Under the new IFRS 9 standard, the accounting for certain investments depends on the Council's "business model" for managing them. The Council aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

Approved Counterparties:

45. The Council's Treasury advisors have advised that the Council may invest its surplus funds with any of the counterparty types in the table below, subject to the cash limits (per counterparty) and the time limits shown.

| Credit rating | Banks unsecured | Banks secured | Government | Corporates | Registered Providers |
|---|---|---|---|---|---|
| UK Govt | n/a | n/a | £ Unlimited<br>50 years | n/a | n/a |
| AAA | £2m<br>5 years | £3m<br>20 years | £3m<br>50 years | £2m<br>20 years | £2m<br>20 years |
| AA+ | £2m<br>5 years | £3m<br>10 years | £3m<br>25 years | £2m<br>10 years | £2m<br>10 years |
| AA | £2m<br>4 years | £3m<br>5 years | £3m<br>15 years | £2m<br>5 years | £2m<br>10 years |
| AA- | £2m<br>3 years | £3m<br>4 years | £3m<br>10 years | £2m<br>4 years | £2m<br>10 years |
| A+ | £2m<br>2 years | £3m<br>3 years | £2m<br>5 years | £2m<br>3 years | £2m<br>5 years |
| A | £2m<br>13 months | £3m<br>2 years | £2m<br>5 years | £2m<br>2 years | £2m<br>5 years |
| A- | £2m<br>6 months | £3m<br>13 months | £2m<br>5 years | £2m<br>13 months | £2m<br>5 years |
| None | £1m<br>6 months | n/a | £3m<br>25 years | £1m<br>5 years | £2m<br>5 years |
| Pooled funds and real estate investment trusts | £3m per fund or trust | | | | |

This table must be read in conjunction with the notes below:

Credit Rating:

46. Investment limits are set by reference to the lowest published long-term credit rating from a selection of external ratings agencies. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions

are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

Banks Unsecured:

47. Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

Banks Secured:

48. Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

Government:

49. Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

Corporates:

50. Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either following an external credit assessment or to a maximum of £2 million per company as part of a diversified pool in order to spread the risk widely.

Registered Providers:

51. Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are tightly regulated by the Regulator of Social Housing (in England). As providers of public services, they retain the likelihood of receiving government support if needed.

Pooled Funds:

52. Shares or units in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

53. Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.

Real Estate Investment Trusts:

54. Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties. Investments in REIT shares cannot be withdrawn but can be sold on the stock market to another investor.

Operational Bank Accounts:

55. The Council may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £3 million per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity. Deposits with the Council's current account are restricted to overnight deposits.

Supranational Banks:

56. Loans, bonds and bills issued or guaranteed by Supranational Banks such as the European Investment Bank, European Central Bank, etc. These investments are not to subject to bail-in and there is an insignificant risk of insolvency.

Risk Assessment and Credit Ratings:

57. Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,

- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

58. Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as “rating watch negative” or “credit watch negative”) so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

Other Information on the Security of Investments:

59. The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Council’s treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

60. When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council’s cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned but will protect the principal sum invested.

Investment Limits:

61. In order that no more than 20% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £3 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers’ nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries. Please refer to the table below:

| | Cash limit |
|---|---|
| Any single organisation, except the UK Central Government | £3m each |
| UK Central Government | Unlimited |
| Any group of organisations under the same ownership | £3m per group |
| Any group of pooled funds under the same management | £5m per manager |
| Negotiable instruments held in a broker's nominee account | £10m per broker |
| Foreign countries | £2m per country |
| Registered Providers | £5m in total |
| Unsecured investments with Building Societies | £5m in total |
| Loans to unrated corporates | £2m in total |
| Money Market Funds | £10m in total |

Liquidity Management:

62. The Council uses purpose-built cash flow forecasting software to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments.

**Other Items**

63. There are a number of additional items that the Council is obliged by CIPFA or MHCLG to include in its treasury management strategy. These are shown in Annex B.

**Treasury Management Indicators**

64. The Council measures and manages its exposures to treasury management risks using a range of indicators which members are asked to approve. These are set out at Annex C.

**Corporate Objectives and Key Priorities**

65. The Treasury Management supports the Council's Key Priority 2.

**Policy Framework**

66. The Council complies with the requirements of the CIPFA Code of Practice and Treasury Management. The current relevant criteria and constraints incorporated into the Treasury Management Policy Statement are:

a. New borrowing is to be contained within the limits approved by the Council, in accordance with the CIPFA Prudential Code for Capital Finance in Local Authorities, and the Council's prudential indicators.

b. Investments to be made in accordance with the CLG guidance on Local Council Investments, on the basis of Fitch, Moody's and Standard & Poors credit ratings for rated institutions and as detailed in the Treasury Management Policy statement and approved schedules and practices.

c. Sufficient funds to be available to meet the Council's estimated outgoings for any day.

d. Investment objectives are to maximise the return to the Council, subject to the overriding need to protect the capital sum.

e. The Council's response to interest rate changes is to minimise the net interest rate burden on borrowing and maximise returns from investments, subject to (a-d) above.

**Legal Issues**

67. These are addressed in the report and relate to a requirement to set and agree both a treasury management strategy and prudential indicators.

**Governance Issues**

68. The recommendations address best practice and are required as part of the CIPFA code.

**Sustainability**

69. None

**Risk Management**

70. Poor returns on investments could lead to a reduction in income also to support the revenue budget. However, low returns on investments should mean low rates for borrowing which could offset any potential loss. There is a risk that variable interest rates on short term borrowing could rise faster than expected leading to an increase in cost and therefore leading to savings being needed elsewhere in the Council's budget.

71. The limits proposed in this report in respect to counterparties and investments are the overall limits for agreement by Council. However from time to time these may be tightened temporarily by the Executive Head of Finance in consultation with the portfolio holder for Resources to reflect increased uncertainty and increase in perceived risk in financial institutions and the economy. This will usually be at the cost of lower returns.

72. The investments ratings provided by credit ratings agencies are only a guide and do not give 100% security. There is always a risk that an institution may be unable to repay its loans whatever the credit rating thereby putting the Council's investments at risk.

**Consultation**

73. The Council's treasury advisors have been consulted and advised on the treasury strategy.

**Officer Comments**

74. Treasury Management, in particular the management of debt, is becoming an increasing important are for the Council. This can lead to financial benefits but also carries risks which need to be clearly understood.

| | |
|---|---|
| **Annexes** | Annex A – Arlingclose Economic and Interest Rate Forecast November 2019<br>Annex B – 2020/21 Other Items - Treasury Management Strategy<br>Annex C – 2020/21 Treasury Management Indicators<br>Annex D – Investments as at 30th November 2019<br>Annex E – Existing Investment and Debt Portfolio<br>Annex F – Minimum Revenue Policy (MRP) Statement<br>Annex G – Treasury Management Policy Statement<br>Annex H - Glossary |
| **Background Papers** | CIPFA Code of Practice: Treasury Management in the Public Services – 2017 Edition |
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| **Head of Service** | Kelvin Menon - Executive Head of Finance |

**Annex A**

## Arlingclose Economic & Interest Rate Forecast November 2019

The Council's Treasury Advisors Arlingclose has provided their prediction of interest rates over the next 3 years. This is shown in the table below together with their underlying assumptions and predictions.

### Underlying assumptions:

- The global economy is entering a period of slower growth in response to political issues, primarily the trade policy stance of the US. The UK economy has displayed a marked slowdown in growth due to both Brexit uncertainty and the downturn in global activity. In response, global and UK interest rate expectations have eased.

- Some positivity on the trade negotiations between China and the US has prompted worst case economic scenarios to be pared back. However, information is limited, and upbeat expectations have been wrong before.

- Brexit has been delayed until 31 January 2020. While the General Election has maintained economic and political uncertainty, the opinion polls suggest the Conservative position in parliament may be strengthened, which reduces the chance of Brexit being further frustrated. A key concern is the limited transitionary period following a January 2020 exit date, which will maintain and create additional uncertainty over the next few years.

- UK economic growth has stalled despite Q3 2019 GDP of 0.3%. Monthly figures indicate growth waned as the quarter progressed and survey data suggest falling household and business confidence. Both main political parties have promised substantial fiscal easing, which should help support growth.

- While the potential for divergent paths for UK monetary policy remain in the event of the General Election result, the weaker external environment severely limits potential upside movement in Bank Rate, while the slowing UK economy will place pressure on the MPC to loosen monetary policy. Indeed, two MPC members voted for an immediate cut in November 2019.

- Inflation is running below target at 1.7%. While the tight labour market risks medium-term domestically-driven inflationary pressure, slower global growth should reduce the prospect of externally driven pressure, although political turmoil could push up oil prices.

- Central bank actions and geopolitical risks will continue to produce significant volatility in financial markets, including bond markets.

**Forecast:**

- Although we have maintained our Bank Rate forecast at 0.75% for the foreseeable future, there are substantial risks to this forecast, dependant on General Election outcomes and the evolution of the global economy.

- Arlingclose judges that the risks are weighted to the downside.

- Gilt yields have risen but remain low due to the soft UK and global economic outlooks. US monetary policy and UK government spending will be key influences alongside UK monetary policy.

- We expect gilt yields to remain at relatively low levels for the foreseeable future and judge the risks to be broadly balanced.

| | Dec-19 | Mar-20 | Jun-20 | Sep-20 | Dec-20 | Mar-21 | Jun-21 | Sep-21 | Dec-21 | Mar-22 | Jun-22 | Sep-22 | Dec-22 | Average |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Official Bank Rate | | | | | | | | | | | | | | |
| Upside risk | 0.00 | 0.00 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | **0.21** |
| Arlingclose Central Case | **0.75** | **0.75** | **0.75** | **0.75** | **0.75** | **0.75** | **0.75** | **0.75** | **0.75** | **0.75** | **0.75** | **0.75** | **0.75** | **0.75** |
| Downside risk | -0.50 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | **-0.73** |
| 3-month money market rate | | | | | | | | | | | | | | |
| Upside risk | 0.10 | 0.10 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 | **0.25** |
| Arlingclose Central Case | **0.75** | **0.75** | **0.75** | **0.75** | **0.75** | **0.75** | **0.75** | **0.75** | **0.75** | **0.75** | **0.75** | **0.75** | **0.75** | **0.75** |
| Downside risk | -0.50 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | **-0.73** |
| 1yr money market rate | | | | | | | | | | | | | | |
| Upside risk | 0.10 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.25 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 | **0.23** |
| Arlingclose Central Case | **0.85** | **0.85** | **0.85** | **0.85** | **0.85** | **0.85** | **0.85** | **0.85** | **0.85** | **0.85** | **0.85** | **0.85** | **0.85** | **0.85** |
| Downside risk | -0.30 | -0.50 | -0.55 | -0.65 | -0.65 | -0.65 | -0.65 | -0.65 | -0.65 | -0.65 | -0.65 | -0.65 | -0.65 | **-0.60** |
| 5yr gilt yield | | | | | | | | | | | | | | |
| Upside risk | 0.30 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.40 | 0.45 | 0.45 | 0.45 | **0.37** |
| Arlingclose Central Case | **0.50** | **0.50** | **0.50** | **0.55** | **0.60** | **0.60** | **0.60** | **0.60** | **0.60** | **0.60** | **0.60** | **0.60** | **0.60** | **0.57** |
| Downside risk | -0.35 | -0.50 | -0.50 | -0.55 | -0.60 | -0.60 | -0.60 | -0.60 | -0.60 | -0.60 | -0.60 | -0.60 | -0.60 | **-0.56** |
| 10yr gilt yield | | | | | | | | | | | | | | |
| Upside risk | 0.30 | 0.30 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.40 | 0.40 | 0.45 | 0.45 | **0.37** |
| Arlingclose Central Case | **0.75** | **0.75** | **0.80** | **0.80** | **0.85** | **0.85** | **0.90** | **0.90** | **0.95** | **0.95** | **1.00** | **1.00** | **1.00** | **0.88** |
| Downside risk | -0.40 | -0.40 | -0.40 | -0.40 | -0.45 | -0.45 | -0.45 | -0.45 | -0.50 | -0.50 | -0.50 | -0.50 | -0.50 | **-0.45** |
| 20yr gilt yield | | | | | | | | | | | | | | |
| Upside risk | 0.30 | 0.30 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.40 | 0.40 | 0.45 | 0.45 | **0.37** |
| Arlingclose Central Case | **1.20** | **1.20** | **1.25** | **1.25** | **1.25** | **1.30** | **1.30** | **1.30** | **1.35** | **1.35** | **1.35** | **1.40** | **1.40** | **1.30** |
| Downside risk | -0.40 | -0.40 | -0.45 | -0.45 | -0.45 | -0.45 | -0.45 | -0.45 | -0.45 | -0.45 | -0.45 | -0.50 | -0.50 | **-0.45** |
| 50yr gilt yield | | | | | | | | | | | | | | |
| Upside risk | 0.30 | 0.30 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.40 | 0.40 | 0.45 | 0.45 | **0.37** |
| Arlingclose Central Case | **1.20** | **1.20** | **1.25** | **1.25** | **1.25** | **1.30** | **1.30** | **1.30** | **1.35** | **1.35** | **1.35** | **1.40** | **1.40** | **1.30** |
| Downside risk | -0.40 | -0.40 | -0.45 | -0.45 | -0.45 | -0.45 | -0.45 | -0.45 | -0.45 | -0.45 | -0.45 | -0.50 | -0.50 | **-0.45** |

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 1.80%
PWLB Local Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

**<u>Other Items</u>**

There are a number of additional items that the Council is obliged by CIPFA or MHCLG to include in its Treasury Management Strategy.

1. **Financial Derivatives**

   Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

2. The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

3. Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

4. At the moment the Council does not hold any Financial Derivatives.

5. **Investment Advisers**
   The Council has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues. This is monitored by holding regular meetings with the advisers to ensure that they continue to meet the Council's treasury management objectives. In addition, the Council's tender process for treasury management advice ensures value for money.

6. **Investment of Money Borrowed in Advance of Need**
   The Council may, from time to time, borrow in advance of need, where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Council's overall management of its treasury risks.

   The total amount borrowed will not exceed the authorised borrowing limit of £190 million. The maximum period between borrowing and expenditure is not expected to exceed two years, although the Council is not required to link particular loans with particular items of expenditure. At the moment there are no plans to borrow in advance.

7. **Other Options Considered**
The MHCLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Executive Head of Finance, having consulted the Portfolio Member, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

| **Alternative** | **Impact on income and expenditure** | **Impact on risk management** |
|---|---|---|
| Invest in a narrower range of counterparties and/or for shorter times | Interest income will be lower | Lower chance of losses from credit related defaults, but any such losses may be greater |
| Invest in a wider range of counterparties and/or for longer times | Interest income will be higher | Increased risk of losses from credit related defaults, but any such losses may be smaller |
| Borrow additional sums at long-term fixed interest rates | Debt interest costs will rise; this is unlikely to be offset by higher investment income | Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain |
| Borrow short-term or variable loans instead of long-term fixed rates | Debt interest costs will initially be lower | Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long term costs may be less certain |
| Reduce level of borrowing | Saving on debt interest is likely to exceed lost investment income | Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain |

**Markets in Financial Instruments Directive**

The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, The Executive Head of Finance believes this to be the most appropriate status.

**Annex C**

## Treasury Management Indicators 2020/21

The Council measures its exposure to treasury management risks using the following indicators. The Council is asked to approve these indicators:

1. Security – Average Credit Rating

The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio.

| | Target |
|---|---|
| Portfolio average credit rating | A |

This is calculated by applying a score to each investment (AAA = 1, AA+=2, etc.) and taking the arithmetic average weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

2. Liquidity: cash available within three months

The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing.

| | Target |
|---|---|
| Total cash available within 3 months | £5m |

3. Interest Rate Exposures:

This indicator is set to control the Council's exposure to interest rate risk. The Council holds investments of £22 million and variable rate borrowing of £109 million which equates to net borrowing of £87 million. The limit on one-year revenue impact of a 1% rise in interest rates has been set at £1 million. The Council has sufficient reserves in an Interest Equalisation Reserve to mitigate the impact of an interest rate rise for 2019/20.

The Council has also fixed £50 million of these loans which are due to start in 2020/21 at an average rate of 2.88% thereby reducing its interest rate exposure.

4. Maturity Structure of Borrowing**:**

This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

| Refinancing rate risk indicator | Upper limit | Lower limit |
|---|---|---|
| Under 12 months | 100% | 0% |
| 12 months and within 24 months | 100% | 0% |
| 24 months and within 5 years | 100% | 0% |
| 5 years and within 10 years | 100% | 0% |
| 10 years and within 20 years | 100% | 0% |
| 20 years and within 30 years | 100% | 0% |
| 30 years and within 40 years | 100% | 0% |
| Over 40 years | 100% | 0% |

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment. This table means there is total flexibility on borrowing periods to achieve the most cost effective option.

5. Principal Sums Invested for Periods Longer than a year**:**

The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

| | 2020/21 | 2021/22 | 2022/23 |
|---|---|---|---|
| Limit on principal invested beyond year end | £2.5m | £2.5m | £2.5m |

## Annex D

**INVESTMENTS as at 30th November 2019**

| | £ |
|---|---|
| Debt Management Office | 250,000 |
| | |
| AAA Rated MM Fund - Aberdeen Standard | 3,000,000 |
| AAA Rated MM Fund - Blackrock | 3,000,000 |
| AAA Rated MM Fund - CCLA Public Sector Deposit Fund | 1,000,000 |
| AAA Rated MM Fund - Legal and General | 3,000,000 |
| **Total Money Market Funds** | **10,000,000** |
| | |
| CCLA Property Fund | 2,184,488 |
| **Total Longer Term Investments** | **2,184,488** |
| | |
| **Total Invested (excluding the NatWest Business Reserve)** | **12,434,488** |
| | |
| NatWest Business Reserve | 107,671 |
| | |
| **Total Invested (including NatWest Business Reserve)** | **£12,542,158** |

**Annex E**

**Existing Investment & Debt Portfolio**

| | **30-Nov-19<br>Actual Portfolio<br>£m** | **30-Nov-19<br>Average Rate<br>%** |
|---|---|---|
| **External Borrowing:** | | |
| Public Works Loan Board - Long Term | **(56.39)** | 2.4% |
| Local authorities - Short Term | **(107.75)** | 0.8% |
| **Total Gross External Debt** | **(164.14)** | **1.3%** |
| **Investments:** | | |
| Banks & Building societies | 0.11 | 0.1% |
| Government (incl. local authorities) | 0.25 | 0.5% |
| Money Market Funds | 10.00 | 0.7% |
| Other Pooled Funds | 2.18 | 5.0% |
| **Total Treasury Investments** | **12.54** | **1.6%** |
| **Net Debt** | **(151.60)** | **0.3%** |

**Annex F**

## Minimum Revenue Policy (MRP) Statement

1. The Secretary of State under section 21(1A) of the Local Government Act 2003 issued guidance on the calculation of MRP in February 2012 with 2012 being the first year of operation. The Council has assessed its method of MRP and is satisfied that the guidelines for its annual amount of MRP set out within this policy statement will result in its making the prudent provision that is required by the guidance.

2. For capital expenditure incurred and funded through borrowing the Council will calculate MRP using the asset life method as summarised in the table below. MRP will be based on the estimated life of the assets purchased by unsupported borrowing.

| **Estimated economic lives of assets** | **Estimated economic life** |
|---|---|
| Asset Class | |
| Land and heritage assets | 50 years |
| Buildings and services | 50 years |
| Vehicles and Plant | 10 years |
| IT equipment and software | 5 years |
| Investment property | 50 years |
| Assets for regeneration and/or under construction | 0% until development complete |

3. The Council will aim to minimise the impact of MRP on the General Fund by only acquiring assets with a longer rather than shorter economic life through borrowing.

4. In accordance with provisions in the guidance MRP will be charged starting in the year following the date an asset becomes operational.

5. The forecast MRP in £m is shown in the table below:

| | **2018/19 actual** | **2019/20 forecast** | **2019/20 budget** | **2020/21 budget** | **2021/22 budget** |
|---|---|---|---|---|---|
| **MRP Payment** | 1.400 | 2.159 | 2.213 | 2.274 | 2.320 |

*Note: The Council may need to amend to MRP policy dependent on Guidance from MHCLG. If this is the case it will be submitted to members again for approval at a later date*

**Annex G**

**Treasury Management Policy Statement**

The Council's financial regulations require it to create and maintain a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury activities, as a cornerstone for effective treasury management.

Definition

1. The Council defines its treasury management activities as: The management of the Council's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

Risk management

2. This Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

Value for money

3. This organisation acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

Borrowing policy

4. The Council greatly values revenue budget stability. Short-term and variable rate loans will only be borrowed to the extent that they either offset short-term and variable rate investments or can be shown to produce revenue savings.

5. The Council will set an affordable borrowing limit each year in compliance with the Local Government Act 2003, and will have regard to the CIPFA Prudential Code for Capital Finance in Local Authorities when setting that limit. It will also set limits on its exposure to changes in interest rates and limits on the maturity structure of its borrowing in the treasury management strategy report each year.

Investment policy

6. The Council's primary objectives for the investment of its surplus funds are to protect the principal sums invested from loss, and to ensure adequate liquidity so that funds are available for expenditure when needed. The generation of investment income to support the provision of local Council services is an important, but secondary, objective.

7. The Council will have regard to the Communities and Local Government Guidance on Local Government Investments and will approve an investment strategy each year as part of the treasury management strategy. The strategy will set criteria to determine suitable organisations with which cash may be invested, limits on the maximum duration of such investments and limits on the amount of cash that may be invested with any one organisation.

**Annex H**

## Glossary of Terms

| | |
|---|---|
| Amortising | A loan or bond where principal is repaid over its term, rather than only on maturity. |
| Annuity | A method of repaying a loan where the cash payment remains constant over the life of the loan, but the proportion of interest reduces and the proportion of principal repayment increases over time. Repayment mortgages and personal loans tend to be repaid by the annuity method. |
| Authorised limit | The maximum amount of debt that a local Council may legally hold, set annually in advance by the Council itself. One of the Prudential Indicators. |
| Bail-in | A method of rescuing a failing financial institution by cancelling some of its deposits and bonds. Investors may suffer a haircut but may be given shares in the bank as part compensation. See also bail-out. |
| Bail-out | A method of rescuing a failing financial institution by the injection of public money. This protects investors at the expense of taxpayers. See also bail-in. |
| Bank of England | The central bank of the UK, based in London, sometimes just called “the Bank”. |
| Bank Rate | The official interest rate set by the Monetary Policy Committee, and the rate of interest paid by the Bank of England on commercial bank deposits. Colloquially termed the “base rate”. |
| Borrowing | Usually refers to the stock of outstanding loans owed and bonds issued. |
| Building society | A mutual organisation that performs similar functions to a retail bank but is owned by its customers. |
| Call account | A deposit account that can be called back, normally on instant access. |
| Capital | (1) Long-term, as in capital expenditure and capital receipt.<br>(2) Principal, as in capital gain and capital value.<br>(3) Investments in financial institutions that will absorb losses before senior unsecured creditors. |
| Capital expenditure | Expenditure on the acquisition, creation or enhancement of fixed assets that are expected to provide value for longer |

| | |
|---|---|
| | than one year, such as property and equipment, plus expenditure defined as capital in legislation such as the purchase of certain investments. |
| Capital finance | Arranging and managing the cash required to finance capital expenditure, and the associated accounting. |
| Capital finance Regulations | Legislation covering local authorities' activities in capital finance, treasury management and accounting. Separate regulations are published for the four nations of the UK. |
| Capital financing requirement | A local Council's underlying need to hold debt for capital purposes, representing the cumulative capital expenditure that has been incurred but not yet financed. The CFR increases with capital expenditure and decreases with capital finance and MRP. |
| Capital gain or loss | An increase or decrease in the capital value of an investment, for example through movements in its market price. |
| CET1 | Core equity tier 1 - the purest form of capital for a financial institution, which is available to absorb losses while it remains a going concern, usually expressed as a ratio to risk weighted assets. |
| Certainty rate | Discount on PWLB rates for new loans borrowed, available to all local authorities that provide a forecast for their borrowing requirements. |
| Certificate of deposit (CD) | A short-term debt instrument, similar to a deposit, but that is tradable on the money markets. |
| CIPFA | The Chartered Institute of Public Finance and Accountancy - the professional body for accountants working in the public sector. CIPFA also sets various standards for local government |
| Collective investment Scheme | Scheme in which multiple investors collectively hold units or shares. The investment assets in the fund are not held directly by each investor, but as part of a pool (hence these funds are also referred to as 'pooled funds'). |
| Cost of carry | When a loan is borrowed in advance of need, the difference between the interest payable on the loan and the income earned from investing the cash in the interim. |
| Counterparty | The other party to a loan, investment or other contract. |

| | |
|---|---|
| Counterparty limit | The maximum amount an investor is willing to lend to a counterparty, in order to manage credit risk. |
| CPI | Consumer Price Index - the measure of inflation targeted by the Monetary Policy Committee, measured on a harmonised basis across the European Union. |
| Credit default swap (CDS) | Derivative for swapping credit risk on a particular issuer, similar to an insurance policy where the buyer pays a premium against the risk of default. Also used as an indicator of credit risk: the higher the premium, the higher the perceived risk. |
| Credit rating | Formal opinion by a credit rating agency of a counterparty's future ability to meet its financial obligations. As it is only an opinion, there is no guarantee that a highly rated organisation will not default. |
| Credit rating agency | An organisation that publishes credit ratings. The three largest agencies are Fitch, Moody's and Standard & Poor's but there are many smaller ones. |
| Credit risk | The risk that a counterparty will default on its financial obligations. |
| Debt | (1) A contract where one party owes money to another party, such as a loan, deposit or bond. Contrast with equity.<br>(2) In the Prudential Code, the total outstanding borrowing plus other long-term liabilities. |
| Default | Failure to meet an obligation under a debt contract, including the repayment of cash or compliance with a covenant, usually as a result of being in financial difficulty (rather than an administrative oversight). |
| Deposit | A regulated placing of cash with a financial institution. Deposits are not tradable on financial markets. |
| Derivative | Financial instrument whose value is derived from an underlying instrument or index, such as a swap, option or future. Derivatives can be used to gain exposure to, or to help protect against, changes in the value of the underlying. See also embedded derivative and hedge. |
| Discount | (1) The amount that the early repayment cost of a loan is below its principal, or the price of a bond is below its nominal value.<br>(2) To calculate the present value of an investment taking account of the time value of money. |

| | |
|---|---|
| Diversification | The spreading of risk across a variety of exposures in order to reduce the risk. For example, investing in a range of counterparties to limit credit risk or borrowing to a range of maturity dates to limit refinancing risk. |
| Dividend | Income paid to investors in shares and collective investment schemes. Dividends are not contractual, and the amount is therefore not known in advance. |
| DMO | Debt Management Office – an executive agency of HM Treasury that deals with central government's debt and investments. |
| Duration | In relation to a bond or bond fund, the weighted average time of the future cash flows from today, usually expressed in years. The longer the duration, the more the price moves for a given change in interest rates. |
| Equity | (1) The residual value of an entity's assets after deducting its liabilities.<br>(2) An investment in the residual value of an entity, for example ordinary shares. |
| Fair value | IFRS term for the price that would be obtained by selling an investment, or paid to transfer debt, in a market transaction. |
| Fiscal policy | Measures taken by government to boost or slow the economy via taxation and spending decisions. Fiscal loosening or easing refers to cuts in taxes or increases in spending, while fiscal tightening refers to the opposite. See also monetary policy. |
| Financial institution | A bank, building society or credit union. Sometimes the term also includes insurance companies. |
| Financial instrument | IFRS term for investments, borrowing and other cash payable and receivable. |
| Forward deal | An arrangement where a loan or deposit is arranged in advance of the cash being transferred, with the advance period being longer than the standard period (if any) for such a transaction. |
| Fund manager | Regulated firm that manages collective investment schemes. |
| GDP | Gross domestic product – the value of the national aggregate production of goods and services in the economy. Increasing GDP is known as economic growth. |

| | |
|---|---|
| General Fund | A local Council reserve that holds the accumulated surplus or deficit on revenue income and expenditure, except on council housing. |
| Gilt | Bond issued by the UK Government, taking its name from the gilt-edged paper they were originally printed on. |
| Gilt yield | Yield on gilts. Commonly used as a measure of risk-free long-term interest rates in the UK. |
| Guarantee | An arrangement where a third party agrees to pay the contractual payments on a loan to the lender if the borrower defaults. |
| IFRS | International Financial Reporting Standards, the set of accounting rules in use by UK local authorities since 2010. |
| Interest | Compensation for the use of cash paid by borrowers to lenders on debt instruments. |
| Interest rate risk | The risk that unexpected changes in interest rates cause an unplanned loss, for example by increased payments on borrowing or lower income on investments. |
| Internal borrowing | A local government term for when actual “external” debt is below the capital financing requirement, indicating that difference has been borrowed from internal resources instead; in reality this is not a form of borrowing. |
| Investment strategy | A document required by investment guidance that sets out a local Council’s investment plans and parameters for the coming year. Sometimes forms part of the Council’s treasury management strategy. |
| Lease | A contract where one party permits another to make use of an asset in return for a series of payments. It is economically similar to buying the asset and borrowing a loan, and therefore leases are often counted as a type of debt. |
| Liquidity risk | The risk that cash will not be available to meet financial obligations, for example when investments cannot be recalled and new loans cannot be borrowed. |
| Loan | Contract where the lender provides a sum of money (the principal) to a borrower, who agrees to repay it in the future together with interest. Loans are not normally tradable on financial markets. There are specific definitions in government investment guidance. |

| | |
|---|---|
| Loans CFR | The capital financing requirement less the amount met by other long-term liabilities; i.e. the amount to be met by borrowing. |
| Local infrastructure rate | Discount on PWLB rates for new loans borrowed, available to local authorities that have been successful in a bidding round. |
| Long-term | Usually means longer than one year. |
| Market risk | The risk that movements in market variables will have an unexpected impact. Usually split into interest rate risk, price risk and foreign exchange risk. |
| Maturity | (1) The date when an investment or borrowing is scheduled to be repaid.<br>(2) A type of loan where the principal is only repaid on the maturity date. |
| MHCLG | Ministry of Housing, Communities and Local Government – the central government department that oversees local authorities in England. |
| MiFID II | The second Markets in Financial Instruments Directive - a legislative framework instituted by the European Union to regulate financial markets in the bloc and improve protections for investors. |
| Monetary policy | Measures taken by central banks to boost or slow the economy, usually via changes in interest rates. Monetary easing refers to cuts in interest rates, making it cheaper for households and businesses to borrow and hence spend more, boosting the economy, while monetary tightening refers to the opposite. |
| Monetary Policy Committee (MPC) | Committee of the Bank of England responsible for implementing monetary policy in the UK by changing Bank Rate and quantitative easing with the aim of keeping CPI inflation at around 2%. |
| Money market fund (MMF) | A collective investment scheme which invests in a range of short-term assets providing high credit quality and high liquidity. Usually refers to CNAV and LVNAV funds with a WAM under 60 days which offer instant access, but the European Union definition extends to include cash plus funds. |
| Money markets | The markets for short-term finance, including deposits and T-bills. See also capital markets. |

| | |
|---|---|
| MRP | Minimum revenue provision - an annual amount that local authorities are required to set aside and charge to revenue for the repayment of debt associated with capital expenditure. Local authorities are required by law to have regard to government guidance on MRP. |
| Municipal bonds agency | Company that issues bonds in the capital market and lends the proceeds back to local authorities. The bonds are guaranteed by the local authorities. |
| Net borrowing | Borrowing minus treasury investments. |
| Operational boundary | A prudential indicator showing the most likely, prudent, estimated level of external debt, but not the worst-case scenario. Regular breaches of the operational boundary should prompt management action. |
| Option | A derivative where the holder pays a premium to have the right, but not the obligation, to buy or sell a security or enter into a defined transaction. |
| Outlook | A credit rating agency's expected direction of travel in the long-term rating over the next two years. |
| Pension Fund | Ring-fenced account for the income, expenditure and investments of the local government pension scheme. Pension fund investments are not considered to be part of treasury management. |
| Pooled fund | See collective investment scheme. |
| Premium | (1) The amount that the early repayment cost of a loan is above the principal, or the price of a bond is above its nominal value. See also discount.<br>(2) The initial payment made under a derivative. |
| Price risk | The risk that unexpected changes in market prices lead to an unplanned loss. Managed by diversifying across a range of investments. |
| Principal | The amount of money originally lent on a debt instrument. |
| Private Finance Initiative (PFI) | A government scheme where a private company designs, builds, finances and operates assets on behalf of the public sector, in exchange for a series of payments, typically over 30 years. Counts as a credit arrangement and debt. |
| Professional client | MiFID II term for a client of a regulated firm that has a higher level of experience in financial markets than a retail client, and therefore needs a lower level of protection. Local |

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| | authorities may “opt up” to be treated as professional clients if they meet certain requirements. |
| Property fund | A collective investment scheme that mainly invests in property. Due to the costs of buying and selling property, including stamp duty land tax, there is usually a significant fee charged on initial investment, or a significant difference between the bid and offer price. |
| Prudential Code | Developed by CIPFA and introduced in April 2004 as a professional code of practice to support local Council capital investment planning within a clear, affordable, prudent and sustainable framework and in accordance with good professional practice. Local authorities are required by law to have regard to the Prudential Code. |
| Prudential indicators | Indicators required by the Prudential Code and determined by the local Council to define its capital expenditure and asset management framework. They are designed to support and record local decision making in a manner that is publicly accountable. |
| PWLB | Public Works Loans Board - a statutory body operating within the DMO that lends money from the National Loans Fund to local authorities and other prescribed bodies and collects the repayments. Not available in Northern Ireland. |
| Quantitative easing (QE) | Process by which central banks directly increase the quantity of money in the economy in order to promote GDP growth and prevent deflation. Normally achieved by the central bank buying government bonds in exchange for newly created money. Reversing QE by selling back bonds, or allowing them to mature without replacement, is sometimes called quantitative tightening. |
| Rating watch | A term used by credit rating agencies to indicate that a credit rating is under review, and that a change is likely within three months. The direction of potential change is usually indicated. |
| Recession | A period of economic slowdown. The technical definition is two consecutive quarters of negative GDP growth. |
| Redemption | The process of withdrawing cash from a collective investment scheme and cancelling the units of shares. Redemptions can be suspended in certain circumstances detailed in the prospectus. |
| Refinancing risk | The risk that maturing loans cannot, be refinanced, or only at higher than expected interest rates leading to an |

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| | unplanned loss. Managed by maintaining a smooth maturity profile. |
| Registered Provider of Social Housing (RP) | An organisation that is registered to provide social housing, such as a housing |
| REIT | Real estate investment trust – a company whose main activity is owning investment property and is therefore similar to a property fund in many ways. |
| Revenue expenditure | Expenditure to meet the ongoing cost of delivering public services including salaries and the purchase of goods and services, as opposed to capital expenditure. |
| Ring-fencing | The process by which large UK banks have been split into retail banks and investment banks in order to promote financial stability. |
| RPI | Retail prices index - an older measure of inflation that tracks the prices of goods and services including mortgage interest and rent. Index-linked gilts are uprated using RPI. See also CPI. |
| Security | (1) A financial instrument that can be traded on a secondary market.<br>(2) The concept of low credit risk.<br>(3) Collateral. |
| Secured investment | An investment that is backed by collateral and is therefore normally lower credit risk and lower yielding than an equivalent unsecured investment. |
| Share | An equity investment, which usually also confers ownership and voting rights. |
| Short-term | Usually means less than one year. |
| Strategic funds | Collective investment schemes that are designed to be held for the long-term, comprising strategic bond funds, diversified income funds, equity funds and property funds. |
| Supported borrowing | Borrowing for which the repayment costs are supported by government grant. |
| Total return | The overall return on an investment, including interest, dividends, rent, fees and capital gains and losses. See also income return. |

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| Treasury investments | Investments made for treasury management purposes, as opposed to commercial investments and service investments. |
| Treasury management | The management of an organisation's cash flows, investment and borrowing, with a particular focus on the identification, control and management of risk. Specifically excludes the management of pension fund investments. |
| Treasury management Advisor | Regulated firm providing advice on treasury management, capital finance and related issues. |
| Treasury Management Code (TM Code) | CIPFA's Code of Practice for Treasury Management in the Public Services and Cross-Sectoral Guidance Notes, to which local authorities are required by law to have regard. |
| Treasury management Indicators | Indicators required by the Treasury Management Code to assist in the management of credit risk, interest rate risk, refinancing risk and price risk. |
| Treasury management policy statement | Document required by the Treasury Management Code setting out a local Council's definition of and objectives for treasury management. |
| Treasury management practices (TMPs) | Document required by the Treasury Management Code setting out a local Council's detailed processes and procedures for treasury management. |
| Treasury management Strategy | Annual report required by the Treasury Management Code covering the local Council's treasury management plans for the forthcoming year. |
| Treasury management System | Computer programme for recording investments, borrowing, cash flow forecasts and market data to assist with treasury management operations. |
| Unit | The equivalent of a share in an authorised contractual scheme or unit trust. |
| Unit trust | A type of collective investment scheme that is structured as a trust, where investors buy units in the trust. |
| Unsupported borrowing | Borrowing where the cost is self-financed by the local Council. Sometimes called prudential borrowing since it was not permitted until the introduction of the Prudential Code in 2004. See also supported borrowing. |
| Usable reserves | Resources available to finance future revenue and/or capital expenditure. Some usable reserves are ring-fenced by law |

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| | for certain expenditure such as on schools or council housing. |
| Volatility | A measure of the variability of a price or index, usually expressed as the annualised standard deviation. |
| Working capital | The cash surplus or deficit arising from the timing differences between income/expenditure in accounting terms and receipts/payments in cash terms. |
| Yield | A measure of the return on an investment, especially a bond. The yield on a fixed rate bond moves inversely with its price. |
| Yield curve | A chart of yields or interest rates for similar instruments over a range of maturity dates. |